Income Tax - Refund Subtraction

What is the state income tax refund subtraction and why is the refund amount subtracted from federal taxable income on the Colorado income tax return?

The amount of state income tax refund included in taxable income on the federal Form 1040 can be subtracted from taxable income on the Colorado income tax return. If you file the federal Form 1040A or 1040EZ, or you did not include your refund on line 10 of the federal Form 1040, you will not be able to claim this subtraction because the refund is already exempt from tax on both the federal and Colorado return.

This subtraction is allowed because the state income tax deduction claimed as an itemized deduction on the federal Schedule A is not allowed as a Colorado deduction due to the state income tax deduction addback on line 2 of the Colorado return. Thus any Colorado or other state income tax refund would not be subject to tax by Colorado and, to the extent included in federal taxable income, such refunds may be subtracted from federal taxable income in determining Colorado taxable income. The subtraction is to be claimed on the Colorado Individual Income Tax Form 104; or on the fiduciary form, Form 105.